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Before the
Federal Communications Commission
Washington, D.C. 20554

FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

In the Matter of)

Implementation of Sections 11)
and 13 of the Cable Television)
Consumer Protection and)
Competition Act of 1992)

Horizontal and Vertical Ownership)
Limits)

MM Docket No. 92-264

COMMENTS OF TIME WARNER ENTERTAINMENT COMPANY, L.P.

August 23, 1993

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Summary

TWE submits that the Commission should promulgate regulations that:

I. SUBSCRIBER LIMITS

- impose only national subscriber limits;
- establish a subscriber limit in the range of 30% to 40%;
- establish a measure of operator size to determine compliance by reference to a percentage which has, (a) as its numerator, the number of cable subscribers served by the cable operator in question, and that has, (b) as its denominator, the sum of (i) the number of all cable subscribers nationally and (ii) the number of subscribers to other multichannel video programming distributors; alternatively, the Commission should adopt a homes passed measure;
- exclude operators who are subject to "effective competition" as defined under Section 3 of the 1992 Cable Act, including the "under 30 percent" provision, for purposes of measuring compliance with subscriber limits;
- adopt attribution criteria that focus on management control and, at a minimum, require a 25% ownership interest for attribution;
- grant the Commission sole enforcement authority of subscriber limits exercised at the Commission's own initiative, without a certification requirement;
- adopt a flexible approach to permit waivers and exceptions, creating a waiver for MSO's who commit de minimis violations, a waiver that permits expansion into unserved rural areas and other appropriate waivers;

- o establish a review of the subscriber limits by the Commission every five years;

II. CHANNEL OCCUPANCY LIMITS

- o craft channel occupancy limits to avoid interfering with technological development, such as TWE's digital switching technology;
- o establish a threshold of 75 channels beyond which the channel occupancy limits no longer apply;
- o exclude non-video services from application of channel occupancy limits;
- o exempt pay-per-view from application of the channel occupancy limits;
- o take account of any broadcast, PEG and leased access channels in the calculation;
- o create an exception to allow systems to carry additional affiliated services where no unaffiliated service has sought carriage;
- o adopt attribution criteria based on management control; alternatively, the Commission should modify the broadcast attribution criteria to increase the 5% attribution threshold to 25% where multiple MSOs have investments in a program service;
- o create an exception for local and regional services such that channel occupancy limits apply only to programming services that are distributed nationally;
- o exempt vertically integrated programming services that have achieved a significant level of distribution among non-affiliated operators from the channel occupancy limits; alternatively, exempt new programming services from the limits for a period of five years;
- o eliminate the application of channel occupancy limits in communities where effective competition exists;

- grandfather existing vertically integrated relationships which exceed the channel occupancy limits;
- grant the Commission the sole authority to enforce the channel occupancy limits on a complaint basis only.

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COMMENTS OF TIME WARNER ENTERTAINMENT COMPANY, L.P.

Preliminary Statement

Time Warner Entertainment Company, L.P. ("TWE"),
is majority owned and fully managed by Time Warner Inc.
("TWI"), a publicly traded company. TWE consists
principally of three unincorporated divisions: Time Warner
Cable ("TWC"), which operates cable systems; Home Box Office
("HBO"), which wholly owns two premium television services
(the HBO service and Cinemax), and is 50% owner of one non-
premium service (Comedy Central); and Warner Brothers, which
produces and distributes motion pictures and television
programs. TWE and TWI also directly and indirectly hold
minority interests in various non-premium cable programming
services other than those owned by HBO.

TWE submits these comments in response to Sections IV and V (relating to subscriber limits and channel occupancy limits) of the Commission's Report and Order and Further Notice of Proposed Rule Making ("FNPRM"), adopted June 24, 1993, and released July 23, 1993, regarding its rule-making responsibilities under Sections 11 and 13 of the Cable Television Consumer Protection and Competition Act of 1992 ("1992 Cable Act"), which amend Section 613 and add Section 617, respectively, to the Communications Act of 1934, 47 U.S.C. §§ 533, 537.

TWE is the plaintiff in a lawsuit pending in Federal District Court in Washington, D.C., in which it takes the position that Section 11 and other provisions of the 1992 Cable Act violate its rights under the First Amendment to the United States Constitution. See Time Warner Entertainment Company, L.P. v. FCC, Civil Action No. 92-2494 (D.D.C. filed Nov. 5, 1992). TWE submits these comments without prejudice to its claims and arguments in that lawsuit.

I. SUBSCRIBER LIMITS

As added by Section 11(c) of the 1992 Cable Act, Section 613 (f)(1)(A) of the Communications Act of 1934, 47 U.S.C. § 533 (f)(1)(A), directs the Commission, within one year after October 5, 1992, "to prescribe rules and regulations establishing reasonable limits on the number of

cable subscribers a person is authorized to reach through cable systems owned by such person, or in which such person has an attributable interest". The Commission has tentatively concluded that a subscriber limit of 25% of total U.S. cable homes passed would be appropriate, and it seeks comment on several issues, which TWE discusses below.

A. National Limits Are Sufficient to Carry Out the Law's Objectives, and Regional Limits Could Impair Efficiencies and Impede Technological Development.

The Commission proposes to adopt exclusively national subscriber limits, and it seeks comment on whether national limits will suffice to implement the 1992 Cable Act. In addition, the Commission inquires whether the benefits of regional concentration outweigh possible anti-competitive effects "on the local advertising and programming marketplace". FNPRM ¶ 138. TWE submits that the Commission's proposal to adopt only national limits is appropriate, and that the benefits of regional concentration outweigh any anticompetitive effects. TWE also believes that the adoption of local or regional limits could jeopardize valuable efficiencies associated with regional concentration and, in particular, interfere with the development of new cable technologies.

In TWE's view, national subscriber limits plainly suffice to implement the objectives of the 1992 Cable Act.

Because most programming distribution occurs on a national basis, any competitive dislocations associated with cable operators' size will be felt at the national level. In addition, as discussed in TWE's Comments dated February 9, 1993 ("TWE Comments"), neither the statutory language nor the legislative history of the 1992 Cable Act shows any concern with the "regional" concentration of cable operators, contains any guidance as to the nature, scope or purpose of any regional subscriber limits, or identifies any regional problems to which such limits would respond. See TWE Comments at 15-18. In promulgating regional subscriber limits, therefore, the Commission would lack any congressional direction.

The benefits of regional concentration outweigh any possible anti-competitive effects on local advertising or programming. The chief local competitors of cable operators both for advertising dollars and for viewership are local broadcast television stations. As other commenters pointed out in response to the Commission's initial Notice of Proposed Rule Making on this subject, cable's share of local advertising revenues is trivial, and as broadcasters themselves often point out, broadcast programming is widely viewed by cable subscribers. Moreover, any competitive imbalance between cable and broadcast in these regards is fully addressed by the must

carry and retransmission consent provisions of the 1992 Cable Act, which empower broadcasters to compel cable operators to distribute their programming, thus ensuring the availability of that programming to local cable audiences and protecting the broadcaster's ability to garner advertising revenue.

Further, as the Commission points out, many of the efficiencies associated with increased concentration in the cable industry are primarily local or regional in character, so that applying local or regional limits would significantly interfere with those efficiencies. FNPRM ¶ 137. For example, a cable operator that has several systems in a particular area can offer expanded customer service and installation hours. Similarly, the efficiencies associated with regional concentration permit cable operators to generate local programming that they otherwise could not generate. ^{1/} Furthermore, as the Commission itself notes, denying cable operators the benefits of regional concentration could impede their ability to become competitors of local telephone companies. FNPRM ¶ 137.

^{1/} For example, TWE, which owns several systems in the New York City area, has been able to develop a 24-hour, all-news network called "New York 1" that covers local New York City news and events. Without a relatively broad New York City subscriber base, TWE would not be able to produce such a service economically.

Nowhere are the benefits of some degree of regional or local concentration more evident than in the development of the cable technologies of tomorrow. As discussed in more detail below, TWE is actively developing a digital cable technology, called the "Full Service Network", which will enable TWE to provide to its subscribers an array of programming so vast that it will render conventional notions about cable channels and programming obsolete. See pp. 18-20 *infra*. Obviously, massive investment is required to implement this new digital technology. The efficiencies associated with regional concentration make such massive investments possible. Imposition of local or regional subscriber limits would jeopardize the ability of innovative companies like TWE to invest in the next generation of cable technology, to the great detriment of consumers.

B. Thirty to Forty Percent of All Multi-Channel Video Subscribers is an Appropriate Subscriber Limit.

The Commission proposes to adopt a horizontal ownership limit prohibiting any one entity from owning cable systems that in the aggregate serve more than 25% of all cable homes passed nationwide, and it seeks comment on subscriber limits in the range of 20% to 35%. FNPRM ¶ 147. From commenters arguing for limits above 25%, the Commission seeks discussion of the effect that such limits will have on the ability of new programming services to obtain

distribution, the competitive rationale for a higher limit, and the effect of the prohibitions under Sections 12 and 19 of the 1992 Cable Act. FNPRM ¶ 149.

As discussed in its earlier Comments (at 21-29), TWE believes that 30% to 40% would be a reasonable subscriber limit. Under antitrust analysis, courts have consistently held that a single firm ordinarily cannot exercise monopoly power without a market share much greater than 30% to 40%. See TWE Comments at 22-24 (collecting cases and other authorities). Indeed, as TWE pointed out in its Reply Comments dated May 12, 1993 ("TWE Reply Comments"), the Commission effectively allows broadcasters to reach 35% of national television households, 25% directly through broadcast and 10% through ownership of cable systems. See TWE Reply Comments at 14-15. Broadcasters thus not only are accorded a larger percentage, but are also accorded greater viewership because there are many more television households than there are cable homes passed. There is no reason to impose constraints on the size of cable operators' audiences that are far more stringent than those on broadcasters' audiences.

Moreover, it is unlikely that a cable operator accounting for less than 30% to 40%, measured either as a percentage of all cable homes passed or on the basis suggested by TWE below, would be able to impair distribution

of a new programming service even if it wished to do so. In such circumstances, an affected programmer could still sell to at least 60% to 70% of all multi-channel subscribers (under TWE's proposed method below) or of all cable homes passed (under the Commission's suggested method). Where such large selling opportunities exist, it is unlikely that the actions of a single operator could significantly impair the distribution of video programming. As TWE pointed out previously, the penetration level needed for commercial success is a function of the economic characteristics of the service, particularly its cost structure. TWE Comments at 25-27. Many services that are very popular today started out with penetration levels well below 60% to 70%, and indeed many successful services have never achieved 60% penetration. TWE Comments at 27-28.

TWE also believes that its proposed 30% to 40% subscriber limit is warranted in view of the prohibitions of Sections 12 and 19 of the 1992 Cable Act. Section 12 authorizes the Commission to regulate various practices relating to program carriage agreements, including conduct "the effect of which is to unreasonably restrain the ability of an unaffiliated video programming vendor to compete fairly by discriminating in video programming distribution on the basis of affiliation or nonaffiliation". 47 U.S.C. § 536. Similarly, Section 19 requires the Commission to

prohibit "unfair methods of competition or unfair or deceptive acts or practices" that have the effect of "hinder[ing] significantly" or "prevent[ing]" a multi-channel video distributor from providing programming to consumers. Given these behavioral regulations, any remaining concerns are adequately addressed by a subscriber limit of 30% to 40%, which will preserve the efficiencies-- including particularly the ability to develop new programming--that are associated with cable operators' growth. 2/

C. The Subscriber Limits Should Take Into Account Subscribership Achieved by Multi-Channel Video Distributors Other Than Traditional Cable Operators.

The Commission proposes to measure subscriber limits as a share of homes passed rather than as a share of cable subscribers, and it seeks comment on whether such a measure is reasonable and appropriate to its objectives. FNPRM ¶ 151. TWE continues to believe that the statutory objectives would be better served by the alternative measure it earlier proposed, in which compliance with the subscriber limits is determined by reference to a percentage that has (a) as its numerator, the number of cable subscribers served by the cable operator in question; and that has, (b) as its

2/ The regulations the Commission proposes to adopt concerning channel occupancy limits would further address any concern about any undue cable operator power.

denominator, the sum of (i) the number of all cable subscribers nationally and (ii) the number of subscribers to other multi-channel video programming distributors. See TWE Comments at 18-21; TWE Reply Comments at 5-6. TWE concurs with the Commission, however, that a homes passed standard is preferable to a standard based solely on a share of cable subscribers.

D. The 1992 Cable Act's "Under 30 Percent" Definition of "Effective Competition" is Relevant in the Context of National Subscriber Limits.

The Commission seeks comment on whether the 1992 Cable Act's assessment that "effective competition" exists where "fewer than 30 percent of the households in the franchise area subscribe to the cable service of a cable system", 47 U.S.C. § 543 (A), is relevant in the context of subscriber limits. FNPRM ¶ 152. TWE believes that it is.

In the first place, the statute defines "effective competition" to include systems with less than 30% penetration, and the Commission has no authority to revise that definition.

Further, including "under 30%" systems is consistent with Congress's purpose. The principal reason for arguing that this portion of the "effective competition" definition is irrelevant to subscriber limits would be that the definition does not explicitly tie the presence of

effective competition to the presence of a competing multi-channel distributor. Thus, it could be argued that even where "effective competition" in this form exists, the operator may still exercise some degree of power over program suppliers simply because no alternative outlet exists in that operator's area. Nonetheless, TWE believes that operators who are subject to "effective competition" under this portion of the definition should still be excluded for purposes of measuring compliance with subscriber limits. First, where an operator achieves penetration of only 30%, it will often be because the operator does face competition from other multi-channel distributors, even if the other definitions of "effective competition" are not met. Second, even if the operator's low penetration is not explained by the presence of a competing distributor, an operator with a penetration level below 30% would still lack any meaningful ability to impede distribution of programming services.

E. The Commission's Attribution Standards Should Focus on Management Control.

The Commission proposes to adopt attribution criteria similar to the broadcast attribution criteria contained in Section 73.3555 of the Commission's Rules. The Commission seeks comment on whether these criteria are appropriate and applicable in the cable context. FNPRM

¶ 156. The Commission also seeks comment on its conclusion that attribution standards need not focus solely on "control" because parties with less than a majority equity interest in a media property can influence management and programming decisions. FNPRM ¶ 159.

TWE continues to believe that the 5% threshold is far too low. Such an ownership interest ordinarily would not confer upon its holder any meaningful say in the business decisions of a cable system. Such a threshold is far more stringent than is required to ensure that operators do not improperly impede the flow of programming from programmers to consumers.

TWE continues to believe that the attribution standard established should focus on the ability of the given cable operator to control the programming choices of the particular cable system. Although such control is ordinarily achieved by majority stock ownership, TWE is not taking the position that attribution should depend only upon voting control. TWE recognizes that control may sometimes be exerted by one having less than a majority interest. Nonetheless, TWE believes that a 5% attribution standard is so low that it is not, in fact, a good proxy for "actual working control", which is what the Section 73.3555 attribution standard seeks to measure. TWE believes that

25% ownership of a cable system is the minimum level at which any imputation of control could possibly be made.

The Commission expresses the view that the legislative history of the 1992 Cable Act supports the use of the broadcast attribution criteria. FNPRM ¶ 157. Although it is true that the Senate Report refers to the broadcast attribution criteria, it also makes clear that the Commission is not required to use those criteria for cable purposes. Indeed, the Senate Report expressly recognizes the possibility that the Commission would deem other attribution criteria to be "appropriate" for purposes of the subscriber limits. S. Rep. No. 92, 102d Cong., 1st Sess. 80 (1991) ("Senate Report"). The Commission has ample discretion to set an attribution threshold above the 5% level.

TWE notes that the Commission is currently reviewing its 5% attribution level for broadcasters and is contemplating an increase to 10%. See Notice of Proposed Rule Making and Notice of Inquiry, 7 FCC Rcd. 2654 (1992). TWE expects that any such revision of the broadcast attribution level would be extended to the cable subscriber limits as well.

F. The Commission Should Enforce the Limits at Its Own Initiative, Make Provision for Waivers, and Review the Limits Every Five Years.

The Commission asks whether the subscriber limits should be enforced through a system of certification applicable to cable operators who currently reach 20% or more of homes passed upon their transfer or assignment of a cable system to another party. FNPRM ¶ 164. As discussed in its earlier Comments (at 32), TWE believes that such a system would be unnecessary. Only one operator--TCI--approaches such limits. Industry publications, while not necessarily precise, are adequate to alert the Commission if TCI (or any other MSO) approaches the subscriber limit. For example, a publication by Paul Kagan Associates, Cable TV Financial Data, provides exhaustive data on subscriber levels in terms of "homes passed".

The Commission also asks whether waivers or exceptions to subscriber limits should be obtainable for MSO's who commit de minimis violations or seek to expand service into a previously unserved rural area. FNPRM ¶ 165. TWE submits that waivers and exceptions are appropriate in these and other circumstances, and should be obtainable. By adopting a flexible approach to the subscriber limits, the Commission will avoid arbitrarily jeopardizing the benefits that efficiencies and economies of scale can provide to

subscribers. For example, the Commission's proposal of a waiver that permits expansion into unserved rural areas (FNPRM ¶ 165) comports with the statutory directive that the Commission's rules "not impose limitations which would bar cable operators from serving previously unserved rural areas". 47 U.S.C. § 533(f)(2)(F). TWE also believes that waivers should be available in the other circumstances described by the Commission as well. See TWE Comments at 33-34.

The Commission also proposes to review the subscriber limits every five years to determine whether they are reasonable under prevailing conditions in the cable industry, given its dynamic nature. FNPRM ¶ 166. TWE agrees that a review every five years would be appropriate and consistent with the statutory purposes. See TWE Comments at 35.

II. CHANNEL OCCUPANCY LIMITS

A. The Commission's Channel Occupancy Limits Threaten to Thwart the Development of Cable Technology.

In its FNPRM, the Commission proposes to establish channel occupancy limits that would prohibit cable operators from devoting more than 40% of their "activated channels" to services of video programmers in which they have an attributable interest. FNPRM ¶¶ 170, 207-211. The Commission requests comment on the effect its proposed

channel occupancy limits will have on technological development in the cable industry, FNPRM ¶ 183, but proposes to defer establishment of any exemption from the limits for cable operators who offer expanded communications capabilities to their subscribers, id. ¶ 227. The Commission also proposes to apply its 40% limit to pay-per-view offerings, id. ¶ 217, and it suggests that it may apply the limit to "the use of cable capacity to provide information and communications services as opposed to video programming services", id. ¶ 183.

TWE respectfully submits that the Commission's proposed course of action threatens to bring the technological evolution of the cable industry to a screeching halt.

First, as we show below, the Commission's channel occupancy limits, which were developed with conventional cable technology in mind, are fundamentally incompatible with--and are rendered unnecessary by--the technological developments that TWE and other cable operators are currently implementing. Further, the next generation of cable technology is not merely preliminary or hypothetical. TWE is making massive investments--as much as \$5 billion in the next five years--to significantly upgrade its distribution facilities, including the implementation of a sophisticated digital switching technology in the great

majority of its cable systems. Thus, contrary to the view expressed in the FNPRM, modification of the channel occupancy limits to accommodate developing cable technologies would not be "premature", FNPRM ¶ 226, nor can the Commission afford to defer consideration of the issue until "a later date", id. ¶ 227. These issues must be addressed now if the industry is to have a degree of regulatory stability that permits such massive investments to be made.

Second, by proposing to apply its channel occupancy limits to pay-per-view and suggesting that those limits might also apply to "information and communications services" other than video programming, the Commission further jeopardizes the technological evolution of the cable industry. As we show below, the Commission lacks statutory authority to regulate either pay-per-view or any information or communications service not constituting video programming. Further, even if the Commission had such authority, sweeping such innovative offerings within the proposed channel occupancy limits would thwart the development of new cable technology or, at a minimum, force it into pathways that do not optimize viewer satisfaction.

TWE stresses that the concerns it raises below are not based on "blue sky" or mere theory, but on concrete business plans. TWE is working today to implement advanced

digital switching technology in its cable systems. To be called the "Full Service Network", TWE's digital switching technology is currently being implemented in TWE's system in Orlando, Florida, and will eventually be implemented in most of TWE's systems. As noted above, TWE intends to spend up to \$5 billion over the next five years in upgrading its cable technology. The bulk of this sum will be devoted to implementing the Full Service Network in various cable systems. TWE views its program to implement the Full Service Network as a vital aspect of the Administration's policy favoring development of a digital "superhighway" for interactive electronic communications.

In the next section, we address the technology-related issues outlined above. Subsequent sections address other issues raised by the FNPRM.

B. The Commission Must Craft Its Channel Occupancy Limits in a Fashion That Will Accommodate Future Technological Development.

1. As Currently Formulated, the Commission's Proposed Channel Occupancy Limits Are Fundamentally Inconsistent with--and Are Rendered Unnecessary by--TWE's Digital Switching Technology.

Through the digital switching technology of TWE's Full Service Network, a subscriber will be able to access a vast, potentially limitless library of programming that is